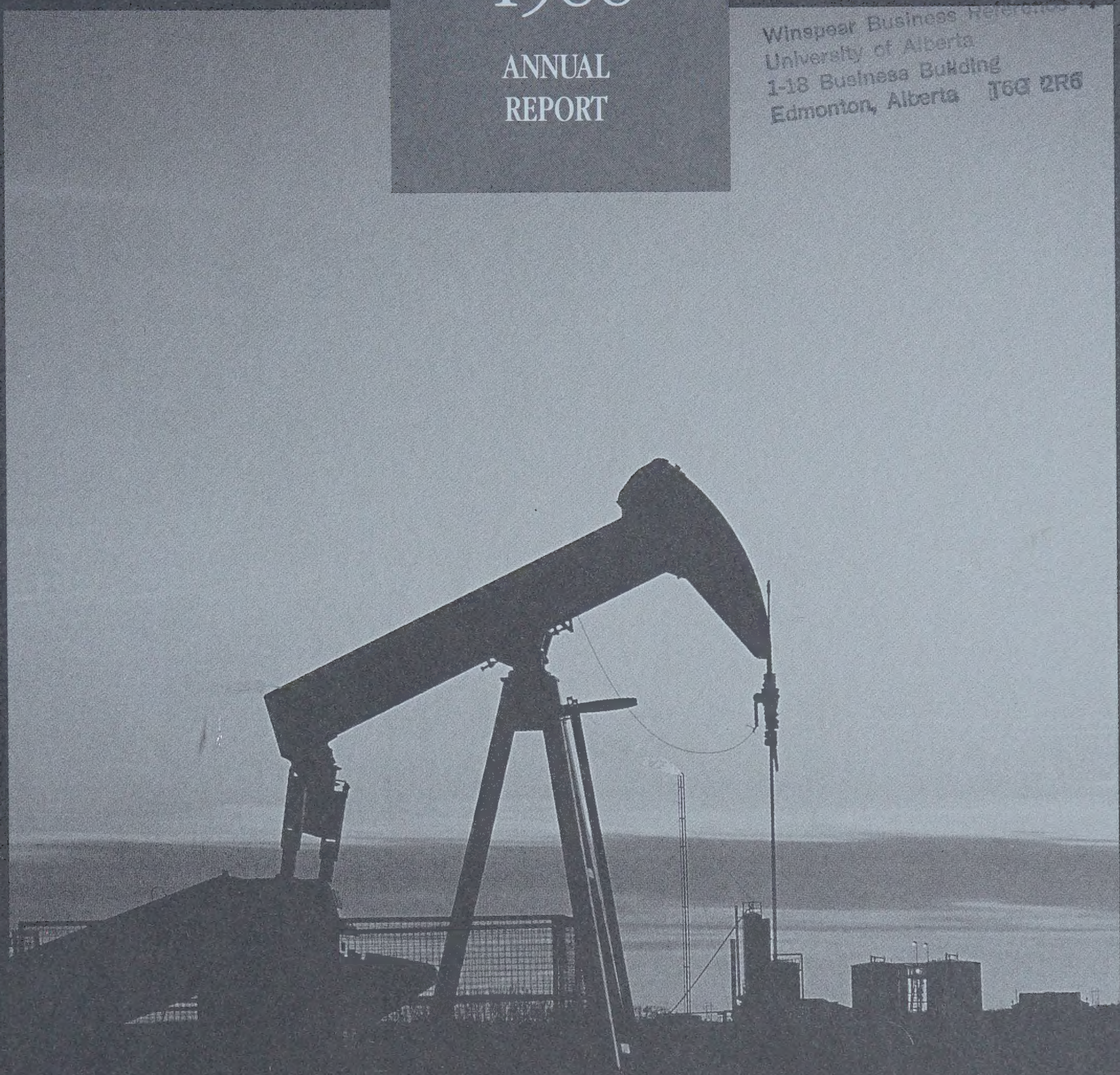
PETROMINES LIMITED

1988

ANNUAL REPORT



HIGHLIGHTS

	1987	1988
FINANCIAL		
(thousands except per share amounts)		
Gross revenues	$ 25,667	$ 19,505
Cash flow	$ 12,291	$ 4,599
Per share — basic	$ 1.03	$ .39
— fully diluted	$ .09	$ .05
Net income (loss)	$ 4,662	$ (2,100)
Per share — basic	$ .39	$ (.18)
— fully diluted	$ .03	$ (.18)
OPERATING		
Production		
Oil (thousands of barrels)	1,145	1,284
Daily average (barrels)	3,138	3,508
Average selling price/bbl	$ 20.06	$ 13.71
Gas (million cubic feet)	1,792	1,314
Daily average (million cubic feet)	4.9	3.6
Average selling price/mcf	$ 1.50	$ 1.45
Reserves (proven and probable)		
Oil (thousands of barrels)	9,460	11,338
Gas (million cubic feet)	9,265	13,507
Discounted value at 15% of estimated future net revenues before income taxes (thousands)	$ 89,200	$ 74,950
Wells drilled (gross)	41	26

ANNUAL MEETING

The Annual General Meeting will be held at 2:00 p.m. (Calgary time) on Thursday, June 1st, 1989 in the Main Boardroom of Renaissance Energy Ltd., Suite 3300, 400 Third Avenue S.W., Calgary, Alberta. Shareholders are encouraged to attend, and those unable to do so should complete the Form of Proxy and forward it at their earliest convenience.

PARENT COMPANY

Renaissance Energy Ltd. owns 75% of the issued common shares of Petromines. Shareholders wishing to obtain a copy of the Renaissance annual report may do so by communicating with the head office.

TO OUR SHAREHOLDERS

The operating environment for the oil and gas industry in 1988 rivaled 1986 for being a year of uncertainty and decline. Downward pressure on natural gas prices continued, reaching a ten-year low in the first quarter of 1988. The year began with rising oil prices and increasing industry optimism. In May, the world oil price began to weaken and the Canadian dollar continued to strengthen. These negative conditions continued through to the fourth quarter of 1988 when the industry was receiving the lowest oil prices in over a decade. The resulting cash flow squeeze caused oil and gas companies to repeatedly reduce their cash flow estimates and capital spending. Activity drew close to a stand still by year-end 1988, and capital expenditure plans for 1989 were reduced or eliminated pending indications of commodity price stabilization. The dilemma of long-term investment decision-making during periods of short-term economic gyrations continued to be a perplexing issue for the industry.

OPERATIONAL REVIEW

In less than three years, Petromines has risen from virtual bankruptcy to a company with a reserve base approaching $75 million. While 1988 results were negatively impacted by weak oil and gas commodity prices, Petromines' asset base and production rates continue to grow. The Company is well positioned to benefit from the recovery in prices occurring in early 1989.

DRILLING RESULTS

Petromines' drilling results over the past two years are tabulated as follows:

	1987		1988	
	Gross	Net	Gross	Net
Oil	28	17	20	14
Gas	6	5	5	5
Dry	7	5	1	1
	41	27	26	20

Petromines has numerous excellent development drilling prospects on its properties. The initial plans for 1988 called for several of these to be drilled; however, the weakness in oil prices in mid-1988 resulted in the deferral of these plans until oil prices increase sufficiently to provide a more acceptable rate of return from the anticipated incremental production.

PETROLEUM AND NATURAL GAS RESERVES

The independent engineering firm, Sproule Associates Limited, has prepared our reserve evaluation. This evaluation covers all of our reserves.

	Reserves Before Royalty		Discounted Value of Estimated Future Net Revenues Before Income Taxes ($ millions)			
	Oil (mbbls)	Gas (mmcf)	0%	10%	15%	20%
Proven producing	4,118	9,698	$ 58.4	$ 42.6	$ 37.6	$ 33.6
Proven non-producing	3,821	1,754	56.4	26.7	19.3	14.4
Total proven	7,939	11,452	114.8	69.3	56.9	48.0
Probable	3,399	2,055	40.3	17.3	12.3	9.2
Total proven and probable	11,338	13,507	155.1	86.6	69.2	57.2
Alberta Royalty Tax Credit	—	—	9.7	6.6	5.7	5.1
January 1, 1989	**11,338**	**13,507**	**$164.8**	**$ 93.2**	**$ 74.9**	**$ 62.3**
January 1, 1988	9,460	9,265	$154.3	$104.3	$ 89.2	$ 77.8
Change	+ 20%	+ 46%	+ 7%	– 11%	– 16%	– 20%

All of the reserve increases are attributable to the 1988 drilling program and the continuing good production performance of our major fields. The decrease in future net revenues is totally attributable to the reduction in the price forecast used by Sproule Associates:

	Oil		Natural Gas
	WTI at Cushing ($US/bbl)	Light Crude at Edmonton ($Cdn/bbl)	WGML Field Price ($Cdn/mcf)
1989	$16.50	$19.39	$1.50
1990	$17.50	$20.63	$1.69
1991	$19.00	$22.44	$1.89
1992	$23.00	$27.33	$2.13
1993	$26.00	$30.98	$2.37
Thereafter	+5%–9%/year	+5%–10%/year	+5%–13%/year

The oil price forecast is based upon the benchmark price of West Texas Intermediate crude oil delivered at Cushing, Oklahoma. This forecast is adjusted for transportation and quality differentials and translated to Canadian dollars at $1 Cdn=$.82 US to reflect Edmonton refinery postings for 40°API crude oil. The gas price forecast is based upon average prices expected to be paid by Western Gas Marketing Limited (WGML), a wholly owned subsidiary of TransCanada Pipelines Limited. In the determination of Petromines's estimated future net revenues, these price forecasts are adjusted for any reserve quality characteristics and the provisions of any applicable gas sales contracts. Probable reserves have been reduced in value by Sproule Associates to account for risk.

The volumes and values attributable to Petromines' major properties, all of which are in the Plains area of Alberta, as determined by Sproule Associates are:

	Oil		Gas		Value*	
	mbbls	%	bcf	%	millions	%
Amisk	8,651	76	—	—	$43.3	58
Forestburg	594	5	6.5	48	9.5	13
Hayter	1,305	12	—	—	9.0	12
Metiskow	701	6	—	—	4.3	6
Chinook	—	—	4.1	30	1.5	2
Three Hills	—	—	2.5	19	1.2	1
Others	87	1	.4	3	0.1	—
	11,338	100	13.5	100	68.9	92
Alberta Royalty Tax Credit					5.7	8
Canadian Exploration and Development Incentives					0.3	—
					$74.9	100

*Estimated future net revenues before income taxes discounted at 15%.

PRODUCTION

Oil production in 1988 increased 12% over 1987 levels primarily as a result of improved performance from the Amisk and Forestburg properties. Gas production declined 27% in 1988 as a result of the poor performance and subsequent abandonment in mid-year of the Amisk gas property. The distribution of Petromines' production in 1987 and 1988 amongst its properties was:

Oil (barrels)	1987	1988
Amisk	1,589	1,812
Metiskow	749	699
Hayter	490	518
Forestburg	310	479
Average daily oil production	3,138	3,508
Gas (million cubic feet)		
Forestburg	2.9	2.2
Amisk	1.8	.9
Other	.2	.5
Average daily gas production	4.9	3.6

Crude oil netbacks in 1988 were almost halved as a direct result of the 32% decline in the average selling price. Natural gas netbacks declined 12% due to a slight reduction in average selling prices and higher operating costs associated with the suspension of production at Amisk.

Oil (per barrel)	1987	1988
Sales price	$20.06	$13.71
Royalties, before credits	(4.29)	(2.80)
Production expenses	(2.70)	(4.05)
Netback per barrel	$13.07	$ 6.86
Gas (per thousand cubic feet)		
Sales price	$ 1.50	$ 1.45
Royalties, before credits	(.19)	(.15)
Production expenses	(.22)	(.34)
Netback per thousand cubic feet	$ 1.09	$ .96

FINANCIAL REVIEW

For ease of comparison, we have summarized our financial results whereby every component of our cash flow and net income is expressed on a per barrel of oil equivalent production basis in the table that follows. Natural gas production volumes are converted to equivalent crude oil barrels, using a ratio of 10:1, which is the most commonly used economic conversion ratio.

Per barrel of oil equivalent @ 10:1	1987	1988
Petroleum and natural gas revenues	$19.38	$13.78
Royalties, net	(1.76)	(1.48)
Production expenses	(2.64)	(3.98)
Operating income	14.98	8.32
General and administrative expenses	(2.02)	(1.43)
Interest expenses	(3.68)	(3.64)
Cash flow	9.28	3.25
Depletion and depreciation	(5.76)	(4.73)
Net income (loss)	$ 3.52	$ (1.48)

Petromines' capital structure is virtually 100% debt financed from its parent company, Renaissance Energy Ltd., and as such is very sensitive to commodity price volatility. The weakness in crude oil prices in 1988 resulted in Petromines' loss, despite the excellent production performance and reserve enhancement achieved over the last two years. Conversely, commodity price increases will have a disproportionately positive impact on our financial performance.

OUTLOOK

In our 1987 annual report, we stated: "In order to facilitate a stepped-up exploration program designed to augment the Company's declining gas reserve base, Petromines intends to dispose of certain proven oil reserves and enter into an acquisition and exploration program in gas prone areas of Alberta. The contemplated disposition of proven oil reserves is a difficult decision; however, the Company's balance sheet is already highly leveraged and will not permit further borrowings. Furthermore, the Company's share trading price does not facilitate the raising of large amounts of new equity capital." The objective of selling some oil reserves in 1988 was not achieved as the weakness in oil prices forestalled our efforts. However, Petromines' status remains unchanged and with the apparent improvement in oil and gas prices in 1989, we expect to capitalize on the strong reserve base to position the Company for further growth.

Ronald G. Greene
Chairman and Chief Executive Officer
April 14, 1989

Clayton H. Woitas
President and Chief Operating Officer

CONSOLIDATED BALANCE SHEET

(Thousands of Dollars)

	December 31	
	1987	1988
ASSETS		
Current Assets		
Cash	$ —	$ 4
Government incentives receivable	3,252	—
Receivable from affiliate (Note 3)	—	1,000
	3,252	1,004
Investment in affiliate (Note 3)	—	2,700
Property, Plant and Equipment, at cost	38,825	43,507
Less accumulated depletion and depreciation	(12,059)	(18,758)
	26,766	24,749
	$ 30,018	$ 28,453
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	$ 60	$ 334
Payable to parent (Note 2)	719	230
	779	564
Loans From Parent (Note 2)	43,261	44,011
Commitments and Contingencies (Note 2)		
SHAREHOLDERS' DEFICIENCY		
Share Capital (Note 4)	1,174	1,174
Retained Earnings (Deficit)	1,804	(296)
Excess of Fair Market Value Over Historical Cost of Net Assets Acquired (Note 7)	(17,000)	(17,000)
	(14,022)	(16,122)
	$ 30,018	$ 28,453

Signed on Behalf of the Board

R.G. Greene, Director and
Chairman of the Board

W.L. Matthews, Director
and Chairman of the Audit Committee

CONSOLIDATED STATEMENT OF INCOME (LOSS) AND RETAINED EARNINGS (DEFICIT)

(Thousands of Dollars)

	Years Ended December 31	
	1987	1988
Operating Income		
Petroleum and natural gas revenues	$ 25,667	$ 19,505
Royalties, net	(2,335)	(2,088)
Production expenses	(3,488)	(5,644)
	19,844	11,773
Expenses (Note 2)		
General and administrative	115	75
Management fee to parent	2,567	1,950
Interest to parent company		
— long-term debt	4,572	5,149
— other	299	—
Cash Flow From Operations	12,291	4,599
Depletion and depreciation	7,629	6,699
Income (Loss) Before the Following	4,662	(2,100)
Deferred income taxes (Note 5)	711	—
Income (Loss) Before Extraordinary Item	3,951	(2,100)
Income tax reduction realized on carryforward of prior years' losses	711	—
Net Income (Loss)	4,662	(2,100)
Retained Earnings (Deficit), beginning of year	(2,858)	1,804
Retained Earnings (Deficit), end of year	$ 1,804	$ (296)

CONSOLIDATED STATEMENT OF CASH FLOW

(Thousands of Dollars)

	Years Ended December 31	
	1987	1988
Operating Activities		
Cash flow from operations	$ 12,291	$ 4,599
Decrease (increase) in working capital, excluding cash	(6,646)	3,109
	5,645	7,708
Financing Activities		
Issue of loan from parent, net	—	750
Cash Available for Investing Activities	5,645	8,458
Investing Activities		
Additions to property, plant and equipment	6,050	5,983
Less government incentives	(661)	(1,301)
	5,389	4,682
Investment in affiliate	—	2,700
Increase in working capital, excluding cash	256	1,072
	5,645	8,454
Increase in Cash	—	4
Cash, beginning of year	—	—
Cash, end of year	$ —	$ 4

AUDITORS' REPORT

To the Shareholders of
Petromines Limited:

We have examined the consolidated balance sheet of Petromines Limited as at December 31, 1987 and 1988 and the related consolidated statements of income (loss) and retained earnings (deficit) and cash flow for the years ended December 31, 1987 and 1988. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1987 and 1988, and the results of its operations and its cash flow for the years ended December 31, 1987 and 1988, in accordance with generally accepted accounting principles applied on a consistent basis.

Calgary, Alberta
March 2, 1989

Arthur Andersen & Co.
Chartered Accountants

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary company.

b) Property, plant and equipment

i) Capitalized costs

The full cost method of accounting for oil and gas properties and related expenditures is followed. Under this method, all costs related to the exploration and development of oil and gas reserves are capitalized. Capitalized costs include those related to lease acquisitions, geological and geophysical activities, lease rentals on non-producing properties, and drilling of productive and non-productive wells. General and administrative and interest expenses are not capitalized.

ii) Depletion and depreciation

Depletion of oil and gas properties and depreciation of production equipment and facilities are calculated on the unit-of-production method based upon:

- total estimated proven developed and undeveloped reserves, before royalty, as determined by independent engineers,
- total capitalized costs plus provision for future development costs of undeveloped reserves as determined by independent engineers,
- relative volumes of oil and gas reserves and production converted at a ratio of six thousand cubic feet of gas to one barrel of oil.

iii) Ceiling test

Under the full cost method of accounting, the carrying amount of property, plant and equipment is limited to a "ceiling" amount as determined by a two part cost recovery test. Under Part I of the test, the carrying amount of property, plant and equipment is limited to estimated future net revenues from proven reserves as determined by independent engineers plus the cost of undeveloped properties less impairment. Under Part II of the test, the carrying amount of the property, plant and equipment net of deferred taxes is limited to the amount determined under Part I of the test less future production related general and administrative expenses, financing costs and applicable income taxes.

The calculation of future net revenues is based upon sales prices and costs and the Income Tax and Alberta Royalty Tax Credit legislation in effect at the end of the period.

At December 31, 1988, no write-down is required under Part I of the ceiling test; however in applying Part II, the carrying amount of property, plant and equipment would be reduced to a nominal amount.

A write-down to a nominal amount in the property accounts is not a meaningful result. However, it is indicative that under present low product prices and the current debt load, the Company would continue to incur losses and would be unable to retire its debt. Since management is unable to estimate the amount of future interest costs to be included in the ceiling test, management has chosen not to write the carrying amount of property, plant and equipment down to an arbitrary amount.

c) Joint Ventures

Substantially all exploration and production activities are conducted jointly with others and, accordingly, the accounts reflect only the Company's proportionate interest in such activities.

2. RELIANCE ON PARENT COMPANY

a) Renaissance Energy Ltd. ("Renaissance" or "Parent") owns 8,944,149 common shares at December 31, 1988, representing 75% of the outstanding common shares. The Parent has advised that they will continue to support the Company in order for it to realize its assets and extinguish its liabilities in the ordinary course of business.

b) Payable to Parent

The payable arises in the normal course of operations. The indebtedness is unsecured and does not have any specified repayment terms.

c) Loans from Parent

A fixed charge debenture aggregating $43,111,000 ($43,261,000 at December 31, 1987) is payable to Renaissance, bears interest at prime plus 1%, and is due on demand. The Company is contingently liable under the debenture for an additional obligation of up to $13,000,000. The obligation, if any, will be calculated in 1992 based upon average oil and gas prices in the period March 1986 to March 1992. The debenture is secured by certain property, plant and equipment. The debenture, including the contingent obligation, is convertible into Third Preferred Shares, Series A at a price of $25 per share.

On April 15, 1988, the Company entered into a financing agreement with Renaissance whereby Renaissance agreed to lend the Company funds to a maximum of $10,000,000. The principal is repayable on demand and bears interest at prime plus 1%. Under this agreement, $900,000 was advanced to the Company during 1988.

Renaissance has indicated its intention to not demand repayment of these loans prior to 1990 and, accordingly, the indebtedness has been classified as long-term.

d) Management Fee

The Company has contracted with Renaissance for the provision of management and administrative services for a fee equal to 10% of gross revenues.

3. INVESTMENT IN AFFILIATE

During 1988, the Company funded approximately $3,700,000 of petroleum and natural gas exploration and development expenditures of an affiliated company. The funding consisted of an investment in 27,000 preferred shares for $2,700,000 and a short-term cash advance of $1,000,000. The affiliate, a joint exploration corporation for income tax purposes, will renounce approximately $2,700,000 of tax deductions to the Company, which have been reflected in Note 5.

4. SHARE CAPITAL

a) Authorized

The Company was incorporated in 1948 pursuant to the laws of the Province of Manitoba and following shareholder approval in August 1986, continued under the laws of the Province of Alberta in October 1986. In conjunction with the continuance, the authorized share capital was amended from 7,500,000 common shares to an unlimited number of shares of each of First Preferred Shares, Second Preferred Shares, Third Preferred Shares, Fourth Preferred Shares and common shares. The four classes of preferred shares may be issued in series.

In January 1987, the directors authorized the following series of preferred shares:

i) Third Preferred Shares, Series A

2,244,440 shares with a stated value of $25 per share carrying a cumulative quarterly dividend of 8½% per annum. Each such share may be converted into one Third Preferred Share, Series B.

ii) Third Preferred Shares, Series B

2,244,440 shares with a stated value of $25 per share carrying a cumulative quarterly dividend equal to a per annum rate of 75% of the average prime bank rate in effect during each quarterly period. Each such share is redeemable at $25 at any time and is convertible into common shares at a rate of $.25 per common share. Each Third Preferred Share, Series B is retractable following a period of five years from the date of issue.

b) **Issued**

Common shares

	Number	Consideration
December 31, 1987 and 1988	11,902	$ 1,174

c) **Reserved for Issue**

At December 31, 1988, 224,444,000 common shares have been reserved for issue upon conversion of the Third Preferred Shares, Series B.

5. DEFERRED INCOME TAXES

The provision for income taxes differs from the result, which would be obtained by applying the combined Canadian Federal and Provincial income tax rate to income (loss) before taxes and extraordinary item. This difference results from the following:

	1987	1988
Effective tax rate	51%	48%
Computed expected tax	$2,378	$(1,008)
Effect on income tax of		
Non-deductible crown royalties	474	421
Resource allowance	(2,172)	(1,143)
Benefit of losses not reflected in financial statements	—	1,633
Other	31	97
Deferred income taxes	$ 711	$ —

As at December 31, 1988, the following deductions are available for income tax purposes:

	Amount	Annual Rate of Claim
Canadian oil and gas property expense	$15,847	10%
Canadian development expense	2,853	30%
Undepreciated capital cost	11,739	25-30%
Canadian exploration expense	3,287	100%
Non-capital losses	4,500	100%
	$38,226	

6. NET INCOME (LOSS) AND CASH FLOW PER SHARE

	Basic		Fully Diluted*	
	1987	1988	1987	1988
Net income (loss) per share				
Before extraordiniary item	$ .33	$ (.18)	$ .03	$ (.18)
Extraordinary item	.06	—	—	—
	$ .39	$ (.18)	$ .03	$ (.18)
Cash flow per share	$ 1.03	$ .39	$ .09	$ .05
Weighted average number of common shares outstanding	11,902	11,902	184,346	184,346
Common shares outstanding at December 31	11,902	11,902	184,346	184,346

*Calculated excluding the potential conversion of $13,000,000 of contingent debt (Note 2.c).

7. BUSINESS COMBINATION

On January 31, 1987, the Company entered into a business combination with Ren-Dev Resources Ltd. ("Ren-Dev") through the amalgamation of 100% of each entity's share capital. The combination was accounted for as a pooling of interests effective December 31, 1986 and accordingly, the historical balances of the entities were carried forward. The oil and gas properties were recorded at their cost of $26,111,000. As the oil and gas properties were previously acquired by Ren-Dev from Renaissance for $43,111,000, the difference of $17,000,000 is shown as part of Shareholders' Deficiency.

CORPORATE DIRECTORY

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Toronto, Ontario

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and Secretary
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Robert K. Dixon
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Jonathan H. Deitcher*
Vice-President and Director
RBC Dominion Securities Inc.
Montreal, Quebec

Clayton H. Woitas
President and Chief
Operating Officer
Renaissance Energy Ltd.
Calgary, Alberta

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Alberta Stock Exchange
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